MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2016/2017

BFN3084 – INTERNATIONAL FINANCE

(All sections / Groups)

11th OCTOBER 2016
9:00 a.m. – 11:00 a.m.
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of **THREE** printed pages (excluding this cover page) with **FIVE** structured questions only.
2. Answer **ALL FIVE** questions. Mark distribution for each question is given.
3. Please print all your answers in the Answer Booklet provided.

QUESTION 1 (20 MARKS)

A Malaysian firm holds an asset in Great Britain and faces the following scenario after the Brexit:

	State 1	State 2	State 3
Probability	30%	30%	40%
Spot rate	RM4.5/£	RM5/£	RM5.5/£
P^*	£4,000,000	£5,000,000	£6,000,000
P	RM18,000,000	RM25,000,000	RM33,000,000

Where:

P^* = Pound sterling price of the asset held by the Malaysian firm
P = ringgit price of the same asset

a. What is the expected value of the investment in ringgits?

(2 marks)

b. What is the variance of the exchange rate?

(4 marks)

c. What is the "exposure" (i.e. the regression coefficient beta)?

(4 marks)

d. Can most of the volatility of the ringgit value of the British asset be removed by hedging exchange risk?

(10 marks)

QUESTION 2 (20 MARKS)

ABC and XYZ Companies can borrow at the following rates (Note that LIBOR refers to as London Interbank Offered Rate):

	ABC	XYZ
S&P's credit rating	AAa	BBa
Fixed-rate borrowing cost	5%	8%
Floating-rate borrowing cost	LIBOR + 1%	LIBOR + 2.5%

a. Calculate the quality spread differential (QSD). Please indicate the potential cost saving and the effective cost of borrowing for each company.

(10 marks)

Continued...

b. Develop an interest rate swap in which ABC and XYZ both agree to share an equal cost saving while the swap bank wants to earn an interest rate of 0.5%. Assume that ABC desires a floating-rate debt and XYZ desires a fixed-rate debt.

(10 marks)

QUESTION 3 (20 MARKS)

Thunder-blend sold coffee beans to Starbuck in Australia on credit and invoiced an amount of AUD10 million payable in three months. Currently, the three-month forward exchange rate is RM3.1/AUD and the foreign exchange advisor for Thunder-blend predicts that the spot rate is likely to be RM2.9/AUD in three months.

a. What is the expected gain/loss from the forward hedging?

(7 marks)

b. If you were the financial manager of Thunder-blend, would you recommend hedging this Australian dollar receivable amount? Why or why not?

(7 marks)

c. Suppose the foreign exchange advisor predicts that the future spot rate will be higher than the forward exchange rate quoted today. Would you recommend hedging in this case? Why or why not?

(6 marks)

QUESTION 4 (20 MARKS)

Briefly define seven (7) major types of international bond market instruments, noting their distinguishing characteristics.

QUESTION 5 (20 MARKS)

Currently, the spot exchange rate is RM4.08/$ and the three-month forward exchange rate is RM3.9/$. The three-month interest rate is 6% per annum in Malaysia and 2.0% per annum in the U.S. Assume that you can borrow as much as RM4,080,000 or USD$1,000,000.

Continued...

a. Determine whether the interest rate parity (IRP) is currently holding.

(7 marks)

b. If the IRP is not holding, how would you carry out covered interest arbitrage? Show all the steps and determine the arbitrage profit.

(7 marks)

c. Explain how the IRP will be restored as a result of covered arbitrage activities.

(6 marks)

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